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In The
Supreme Court of the United States
October Term, 1991

EASTMAN KODAK COMPANY,

Petitioner,
vs.

IMAGE TECHNICAL SERVICES, INC. *et al.*,
Respondents.

On Writ Of Certiorari To The United States Court
Of Appeals For The Ninth Circuit

BRIEF OF AMICI CURIAE NATIONAL
ASSOCIATION OF STATE PURCHASING
OFFICIALS AND NATIONAL INSTITUTE OF
GOVERNMENTAL PURCHASING, INC.
IN SUPPORT OF RESPONDENTS

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF AMICI	1
SUMMARY OF ARGUMENT.....	2
ARGUMENT	3
The Issue of Market Power in Aftermarkets is a Fact Question That Cannot Be Resolved on This Record by a "Per Se" Rule of Competitiveness	3
A. Governments are Major Purchasers of Photo- copiers and Micrographic Equipment	5
B. A Competitive Service Aftermarket Provides the Best Value.....	5
C. Procurement Rules Result in Market Imperfec- tions	7
D. Separation of Purchasing and Operating Func- tions in Government Results in Market Imperfec- tions.....	10
E. The "Lock-In" Effect Results in Market Imperfec- tions	12
F. The <i>Matsushita</i> Standard Applied.....	13
CONCLUSION	15

TABLE OF AUTHORITIES

	Page
CASES:	
<i>Image Technical Services, Inc. v. Eastman Kodak Co.,</i> 903 F.2d 612 (9th Cir. 1990).....	4
<i>Jefferson Parish Hospital Dist. No. 2 v. Hyde</i> , 466 U.S. 2 (1984).....	4, 7, 14
<i>Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio</i> Corp., 475 U.S. 574 (1986).....	13, 14
<i>NCAA v. Board of Regents</i> , 468 U.S. 65 (1984).....	2
<i>Parts and Elec. Motors, Inc. v. Sterling Elec., Inc.</i> , 866 F.2d 228 (7th Cir. 1988).....	8
<i>United States v. E.I. DuPont deNemours & Co.</i> , 351 U.S. 377 (1956)	4
STATUTES:	
15 U.S.C. Section 1	2
Alaska Statute 36.30.005	10
Alaska Statute 36.30.100	2
Alaska Statute 36.30.150(b).....	9
Alaska Statute 36.30.170(a).....	8
1991 Session Laws of Alaska, Chapter 73	10
1991 Session Laws of Alaska, Chapter 96, Sec. 163	10
RULES:	
Federal Rule of Civil Procedure 56.....	7

INTEREST OF AMICI

The National Association of State Purchasing Officials and the National Institute of Governmental Purchasing, Inc. file this brief as amici curiae in support of Respondents, Image Technical Services, Inc., et al.

The National Association of State Purchasing Officials ("NASPO") is a non-profit affiliate of the Council of State Governments. NASPO is comprised of the heads of the purchasing agencies of all fifty States, the District of Columbia, Puerto Rico, the Virgin Islands, Guam, American Samoa, and the Northern Mariana Islands.

The National Institute of Governmental Purchasing, Inc. ("NIGP") is a non-profit educational and technical organization of State and local governmental buying agencies. The members of NIGP include over 1,300 governmental purchasing agencies of the United States, the fifty States, the Provinces of Canada, and many county, city and municipal governments.

The members of NASPO and NIGP purchase a combined total of about \$550 billion in goods and services annually on behalf of State and local taxpayers. State governments alone purchase more than \$200 billion annually. These purchases include Kodak photo-copiers and micrographic equipment, and related purchases of supplies, replacement parts and repair services for those machines.

This case arises under the Sherman Act, 15 USC § 1 *et seq.* (1982), intended by Congress to encourage competition and protect the interests of consumers. See *NCAA v. Board of Regents*, 468 U.S. 65, 107 (1984). NASPO and NIGP have strong interests in promoting competition among suppliers of goods and services to governmental consumers. The members of both organizations seek to obtain the best quality product, at the lowest price, for the taxpayers. "More value for the tax dollar" is NIGP's informal motto.

The goals of NASPO and NIGP are firmly embedded in established public policy. Virtually every State and local government in the United States is required, by law, to use competitive processes to purchase goods and services. See e.g., Alaska Stat. 36.30.100 (. . . unless specifically exempted by law, an agency contract shall be awarded by competitive sealed bidding"). Long experience has shown that vigorous competition among multiple suppliers is essential to obtaining the best product while protecting the public fisc.

The members of NASPO and NIGP are in a unique position to address the practical effects of the issues raised in this case.

SUMMARY OF ARGUMENT

Governments routinely buy expensive pieces of micrographic and photocopier equipment, including Kodak's machines. This equipment must be maintained

and serviced on a regular basis. Without constant attention from skilled technicians, much of today's "high tech" equipment will not function for very long – if at all.

Public agencies are easily locked-in by budget constraints to a particular type of equipment. There are legal constraints on public purchasers which make total cost pricing of equipment difficult. Vigorous competition among multiple service providers is essential for the members of NASPO and NIGP to obtain the "most value for the tax dollar."

Monopolization of aftermarket for parts, and the consequent elimination of competition in the aftermarket for service, is injurious to the public fisc. Tying sales of parts to service leaves the equipment manufacturer free to charge the public agency higher prices for less service than could be obtained in a competitive market.

The factual record in this case is almost nonexistent. The Court of Appeals correctly held that remand was appropriate.

ARGUMENT

THE ISSUE OF MARKET POWER IN AFTERMARKETS IS A FACT QUESTION THAT CANNOT BE RESOLVED ON THIS RECORD BY A "PER SE" RULE OF COMPETITIVENESS

The issue of Kodak's market power is central to the correct resolution of this case. Respondents' tying claims require a showing of "some special ability – usually

called 'market power' – to force a purchaser to do something that he would not do in a competitive market." *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 27 (1984). Similarly, respondents' claims of monopolization require proof that Kodak enjoyed the "power to control prices or exclude competition in the relevant market." *United States v. E.I. DuPont deNemours & Co.*, 351 U.S. 377, 391 (1956).

Kodak argues that a manufacturer that lacks market power in the "interbrand" original equipment market cannot, as a matter of law, wield market power in the aftermarkets for parts and repair services. See Petitioner's Br., 16-27. In an area of particular interest to NASPO and NIGP, Kodak argues that it cannot succeed in overcharging its customers in these aftermarkets: "[a] lock-in strategy works only if Kodak can make more total profit by overcharging its existing customers for service than it will lose as its new and repeat product sales dry up." Petitioner's Br. at 25.

Given the constraints on public purchasing agencies, the members of NASPO and NIGP believe that an equipment manufacturer with market power in the aftermarkets is quite able to make a "lock-in strategy" work in the public sector, regardless of whether the manufacturer has market power in the interbrand equipment market. This is precisely the sort of "market imperfection" the Court of Appeals held can "keep economic theories about how consumers will act from mirroring reality." *Image Technical Services, Inc. v. Eastman Kodak Co.*, 903 F.2d 612, 617 (9th Cir. 1990).

A.

Governments Are Major Purchasers of Photocopiers and Micrographic Equipment.

State, county and local governments are among the nation's largest purchasers of copiers and micrographic equipment. This equipment is necessary to perform essential governmental services at a manageable cost. Court records in the State of Alaska, for example, are transferred to microfiche for permanent storage and easy retrieval. Land records, once kept in rows and rows of dusty books, are maintained in easily accessed microfiche files. With the assistance of computers, these records can be searched quickly, accurately and inexpensively by the public.

Similarly, photocopiers (low, medium, and high volume) are fixtures in virtually every State and local governmental office in the nation. It may well be, as some say, that the invention of the photocopier was the greatest advance in printing since moveable type. Combined with the desktop publishing capacities of personal computers, photocopiers have become essential in government operations.

B.

A Competitive Service Aftermarket Provides the Best Value.

Micrographic equipment and photocopiers are expensive to buy and to operate. The initial capital outlay is substantial, not only for the machines themselves but for their associated "systems" – data retrieval software,

for example, and employee training. To amortize the cost of these expensive machines at an affordable level, State and local governments need to keep them in operation for as long as possible. As the District Court observed, "customers who have purchased Kodak equipment in a competitive market will tend to retain that equipment for its economic life." Pet. App. 34B. Put another way, once the equipment purchase is made, the public agency is "on the hook" for parts and service until the equipment wears out.

Where can the governmental agency turn for parts and service? Its interest is in obtaining the best value for the least cost to the taxpayer. This combination is not always found in the cumbersome bureaucracies of equipment manufacturers like Kodak. In response to demand for better (and cheaper) service than that provided by manufacturers, independent service organizations have sprung up to provide specialized and aggressive service for the owners of many types of equipment, including copiers and micrographic equipment. See, e.g., JA 420, 425-27, 474-75 and 482-84.

An independent service organization may not be able to manufacture a microfiche machine, but it is likely to do a quicker, cheaper and often better job of servicing that machine than the original manufacturer.¹ The members

¹ The Court of Appeals accurately found that evidence in the record of Kodak's own conduct suggests that "the demand for parts can be separated from the demand for service." 903 F.2d at 616. In the view of the more than 1,300 public purchasing agencies which make up NASPO and NIGP, this conclusion

(Continued on following page)

of NASPO and NIGP have found that a competitive environment, where independent service organizations compete fiercely among themselves and with manufacturers, results in lower prices and better customer service. The challenge from independent organizations sharpens the manufacturers' response to its customer's problems; the smaller, more flexible independent organizations adapt quickly to new market needs. The record confirms the experience of NASPO and NIGP members. See, e.g., JA 420 ¶ 30, JA 424-35 ¶¶ 42-47, JA 451 ¶ 5 and JA 536 ¶¶ 5-7.

To effectively compete, these independent service entrepreneurs need parts. As any owner of a photocopier can aver, high technology equipment needs maintenance and repair ceaselessly – and virtually every service call requires parts. By exploiting its control over parts, and starving the independent service organizations, a manufacturer can force the public agency to buy service from it: "a tied product that the buyer . . . might have preferred to purchase elsewhere on different terms." *Jefferson Parish Hosp.*, 466 U.S. at 12.

C.

Procurement Rules Result in Market Imperfections.

Kodak argues that an equipment manufacturer which uses this power to overcharge its customers will soon

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is correct. The development and early success of Respondents' businesses is additional evidence from which it may be inferred that parts and service are separate markets in the photocopier and micrographic industries. Fed. R. Civ. Pro. 56.

find its sales of new equipment declining. Petitioner's Br. at 26. Thus, it argues, overcharging in the aftermarkets is an "implausible strategy," or in Judge Posner's pithy phrase, "a short-run game." *Id.*, citing *Parts and Elec. Motors, Inc. v. Sterling Elec., Inc.*, 866 F.2d 228, 236 (7th Cir. 1988) (Posner, J., dissenting). Kodak's economic theory is largely irrelevant to the real world of public purchasing.

Government agencies face restrictions not found in the private sector. One of these is the requirement of competitive bidding. As a matter of public policy, State and local governments almost uniformly use competitive bidding to obtain the lowest price. Where more than one supplier exists (*i.e.*, where there is "interbrand" competition), most public agencies are required by law to buy equipment from the lowest bidder. *See, e.g.*, Alaska Stat. 36.30.170(a) ("the procurement officer shall award a contract . . . to the lowest responsible and responsive bidder"). A rational bidder can "low-ball" the price for its equipment, and make up for lost profits by higher service costs once the agency is locked-in.

To avoid this, Kodak argues, the consumer will "consider" service costs at the time of purchase. The type of analysis required by Kodak's economic theory – estimating the total (or "life-cycle") cost of a given piece of equipment – is notoriously difficult and imprecise. This is particularly the case for high technology, where there may not be enough data to estimate the cost of maintaining newly developed equipment over the term of its

useful life. Long term service contracts covering the useful life of new equipment, at a fixed cost, are generally not available at the time of purchase.

Consequently, Kodak's approach to purchasing is disfavored by State and local governments. In the State of Alaska, for example, life-cycle costing is only allowed upon a special showing:

A contract based on total or life cycle costs may be awarded only when the chief procurement officer or, for construction contracts or procurement for the state equipment fleet, the commissioner of transportation and public facilities, determines in writing at the time of the contract solicitation that the contract promotes overall economy for the purposes intended, encourages competition, is not unduly restrictive, and is in the best interests of the state.

Alaska Stat. 36.30.150(b).

It takes a courageous purchasing officer to certify that all these factors are present on a bid for untested equipment. Government officials know they are not omniscient in purchasing decisions. The public interest and closely drawn procurement regulations demand that they err on the side of caution. This generally means taking vendors' claims with the proverbial grain of salt, and relying on empirically verifiable specifications rather than the rosy projections of an eager salesman. The "perfectly omniscient consumer," as posited by Kodak, does not exist in the public purchasing sector.

D.

**Separation of Purchasing and Operating Functions
In Government Results in Market Imperfections.**

Kodak's theory also ignores institutional barriers to evaluation of service costs at the time a competitive bid is issued. A central procurement officer may be charged with buying equipment, but is rarely charged with operating, maintaining, or servicing the equipment. See e.g., Alaska Stat. 36.30.005 (centralized procurement authority). Equipment purchased *en masse*, at a quantity discount, may be delivered far and wide across the State, locking-in operating agencies regardless of the availability (or cost) of manufacturer service. The interests of the centralized procurement officer in obtaining the lowest possible cost for equipment may not take into account the total cost to the operating agency, as measured by the cost of parts and service.

Additionally, State and local budgets are subject to a variety of constraints which Kodak's economic theory does not take into consideration. For example, the State of Alaska has different budgets for capital appropriations and for operating expenses. The capital budget funds one-time costs of purchasing equipment, funding construction projects, condemning land, and the like. See e.g., 1991 Session Laws of Alaska, Chapter 96, § 163 (appropriates \$450,000 for purchase of "duplicating equipment"). The operating budget gives agencies the funds needed for the day-to-day-operations of government, including funds to repair and service equipment. See e.g., 1991 Session Laws of Alaska, Chapter 73 (appropriates funds

for "the operating expenses . . . of state government" on an agency basis).

A central procurement officer charged with buying \$450,000 of duplicating equipment will measure success by the number of copiers purchased. Capital funds cannot be used to service the machines, and if not spent will lapse back into the State's general fund. After the copiers are delivered, the recipient agencies use funds from the operating budget to obtain the best quality service at the lowest price to the taxpayer.

Where a competitive aftermarket exists, these goals are complementary. The central procurement officer purchases the maximum amount of equipment for the amount budgeted, possibly obtaining quantity discounts and attracting more bidders by the large scale of the purchase. The operating agency is able to obtain the best value for its budget among competing service organizations.

However, when a manufacturer eliminates competition in the aftermarket, either through monopolization or by tying parts to service, the public purchasing mechanism does not operate effectively. A central purchasing officer, required by law to seek the lowest bid for equipment, using funds which if not spent will lapse, and facing uncertainty in estimating life-cycle costs, is going to award the purchase contract to the lowest bidder. This decision provides a manufacturer with market power in the aftermarket an opportunity to charge higher prices for service than it could charge in a competitive situation. The net result is less value for the taxpayer dollar.

E.**The "Lock-In" Effect Results in Market Imperfections.**

The lock-in effect noted by Respondents in their brief is of special concern to governments. It is not simply the cost of replacing the primary equipment, but associated costs which must be taken into account when analyzing the lock-in effect of an equipment purchase.

For example, governments are major consumers of micrographic equipment. Libraries microfilm books, periodicals, newspapers, and government publications. State archives contain masses of documents, from deeds to birth certificates, which are transferred to microfiche both to save storage costs and to preserve fading or disintegrating paper records from oblivion. Court systems use micrographic systems to record the contents of closed case files, wills, and judicial decisions.

Micrographic systems generally include a computer assisted information retrieval system. A retrieval system can include equipment to record documents on microfiche, a means of encoding data on documents so that it can be read by computer, computer hardware, a software program to tie the whole package together, and terminals so that the public and government employees can access the data. Such a system can cost several hundred thousand dollars in fixed costs, not including the labor needed to design the system so that it meets the needs of the government and the public.

These systems are integrated. That is, the component elements of one element are designed to work together

with those of another. Before a governmental purchaser of Kodak micrographic equipment can rationally consider changing brands, it must consider costs of the entire system. These costs include retraining personnel and recoding data. "Industry standards" for data transfer notwithstanding, changing from one micrographic system to another is fraught with expense and peril. See, e.g., JA 424-425.

In practical terms, the lock-in effect of an initial decision by a public agency to purchase a certain brand of equipment is substantial. This results in market imperfections that, as the Court of Appeals noted, "can keep economic theories about how consumers will act from mirroring reality." 903 F.2d at 617.

F.**The Matsushita Standard Applied.**

The members of NASPO and NIGP have vast experience in public purchasing. They strongly disagree with Kodak's view that it "simply makes no economic sense" that a manufacturer with market power in the parts market will use that power to earn monopoly profits in the service market. Petitioner's Br., at 29; *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986). The nature of public purchasing, budgetary constraints, and the lock-in effect make it quite likely that such an equipment manufacturer – even without market power in the interbrand market – can reap monopoly profits in service through a judicious use of its power over parts.

Kodak's theory that consumers accurately project the lifetime costs of high technology equipment at the time of purchase, accurately weigh the possibility of monopoly rents for parts and service, and take these factors into account when making an initial equipment purchase is simply unrealistic when applied to the public sector. This is not a perfect market, and cannot be examined using theory alone.

If the record were complete, this Court could make an informed decision on the anti-competitive effects of the conduct involved. But the record is not complete. As other amici and Respondents note, the District Court drastically truncated discovery. The Court of Appeals was correctly reluctant to decide this case on a "theoretical basis." 903 F.2d at 617.

Respondents have raised disputed issues of material fact, and – as shown above – their arguments "make[] economic sense." *Matsushita*, 475 U.S. at 587. The public interest is best served by a vigorous, competitive business environment in the aftermarkets for parts and service. When market power over parts is used to restrain competition in service, both competitors and consumers suffer. *Jefferson Parish Hosp.*, 466 U.S. at 15.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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